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UNITED STATES ARMY LEGAL SERVICES AGENCY
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AZ CORP COMMISSION
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Subject: In The Matter Of The Filing Of Tucson Electric Power Company To Amend Decision No.62103, Arizona Corporation Commission Docket No. E-01933A-05-650; AND In The Matter Of The Application Of Tucson Electric Power Company For The Establishment Of Just And Reasonable Rates And Charges Designed To Realize A Reasonable Rate Of Return On The Fair Value Of Its Operations Throughout The State Of Arizona, Arizona Corporation Commission Docket No. E-01933A-07-0402.

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Enclosed for filing with the Arizona Corporation Commission are the original and fifteen copies of the Brief of the Department of Defense in the subject proceeding.

Copies of this Brief have been sent in accordance with the attached Certificate of Service. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,

Peter Q. Nyce Jr.
General Attorney
Regulatory Law Office

Enclosure

Arizona Corporation Commission
DOCKETED

AUG 28 2008

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BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-07-0402
TUCSON ELECTRIC POWER COMPANY FOR)
THE ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
ITS OPERATIONS THROUGHOUT THE)
STATE OF ARIZONA)

IN THE MATTER OF THE FILING BY TUCSON) DOCKET NO. E-01933A-05-650
ELECTRIC POWER COMPANY TO AMEND)
DECISION NO. 62103)

BRIEF OF THE DEPARTMENT OF DEFENSE

TERRANCE A. SPANN
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U. S. Army Litigation Center
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by

Peter Q. Nyce, Jr.
General Attorney

Dated: August 29, 2008

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-07-0402
TUCSON ELECTRIC POWER COMPANY FOR)
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STATE OF ARIZONA)

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ELECTRIC POWER COMPANY TO AMEND)
DECISION NO. 62103)

BRIEF OF THE DEPARTMENT OF DEFENSE

In accordance with instructions from Administrative Law Judge Jane L. Rodda at the conclusion of hearings on the Settlement Agreement ("Agreement") in the subject dockets, the DOD hereby submits its brief.

I. INTRODUCTION

Tucson Electric Power Company ("TEP" or "Company") provides electric service to two major DOD installations: Davis-Monthan Air Force Base ("DM") located in Tucson and Fort Huachuca ("Fort") located in Sierra Vista. Both take service under Large Light & Power Rate Schedule 14 ("LLP-14"). The power usage by these military bases is significant; combined annual consumption exceeds 213,000,000 kilowatt-hours ("kWh").

The primary purpose of DOD's intervention in this case was to address cost of service and rate design issues. In addition, other issues of importance were addressed, namely large-customer DSM and the redesign of TEP's partial requirements service ("PRS") tariffs. The DOD did not take any specific positions on revenue requirements or purchased power and fuel adjustment ("PPFAC") issues.

II. THE DOD SUPPORTS THE AGREEMENT AND RECOMMENDS APPROVAL BY THE ARIZONA CORPORATION COMMISSION ("ACC" or "COMMISSION").

The DOD is a signatory to the Agreement. The Agreement provides for a 6.1% across-the-board increase in rates. Although this provision is not consistent with the results of class cost of service analyses, there are other provisions in the Agreement, as discussed further in this brief, which outweigh this deficiency.

III. THE AGREEMENT IS IN THE PUBLIC INTEREST

Settlements necessarily require concessions by all parties on a variety of important issues. This settlement is no different. The DOD believes that the Agreement provides a reasonable balancing of the interests of both TEP and its customers for a number of reasons. First, the Company receives an overall increase in rates that is materially greater than increases proposed by Staff and intervenors. Second, the parties have agreed on a PPFAC clause that shields the Company from future increases in purchased power and fuel costs. Third, in return, customers will benefit from a four-year rate moratorium. Base rates will remain frozen through December 31, 2012. Fourth, upon Commission approval of the Agreement, the Company will withdraw its proposed hybrid and market methodology filings thereby retaining vertically integrated cost of service as the basis for setting rates in this proceeding. Finally, only \$14 million of the \$788 million regulatory asset requested by the Company is to be included in original cost rate base under the Agreement.

IV. RATE DESIGNS FOR LARGE CUSTOMERS PROVIDE OPPORTUNITIES TO REDUCE POWER COSTS

The Agreement provides for a significant improvement in the rate designs applicable to large customers – customers with demands exceeding 3,000 kilowatts (“KW”). The rate designs proposed in TEP’s filings were not cost-based and would have unfairly penalized customers with high load factors. The revised rate designs stipulated under the Agreement¹ represent a dramatic change from the Company’s original proposals. For instance, under the new LLP-14 rate, demand charges are increased by approximately \$9.00 per KW from present rate levels and summer and winter kWh charges are reduced by \$0.013 and \$0.019, respectively. These changes encourage customers to increase load factors and become more efficient in their use of power. The new optional time-of-use (“TOU”) rate for large customers, rate LLP-90N, provides a strong financial incentive to reduce power costs by reducing and/or shifting peak demands. These improvements in rate design were an important consideration underlying DOD’s decision to opt for the Agreement.

V. NEW PRS, INTERRUPTIBLE AND DEMAND RESPONSE RATE SCHEDULES ARE IMPORTANT AND MUCH NEEDED CHANGES TO THE COMPANY’S TARIFFS

TEP has agreed to file within 90 days of the effective date of the Commission’s approval of the Agreement new PRS tariffs as well as a new interruptible tariff and a demand response program tariff.² TEP’s PRS tariffs discourage rather than encourage large-scale renewable energy projects and many renewables projects are on hold until revised PRS tariffs are approved. The Company is currently conducting workshops on the PRS tariffs issue and will hopefully have revised tariffs available for Commission consideration at the time the Commission decides on the Agreement. The new interruptible and demand response tariffs will provide the Company with two additional demand-reduction tools. Customers that can respond quickly to requests by TEP to reduce demand will benefit

¹ See Exhibit 8 to the Agreement for revised rates LLP-14 and optional TOU rate LLP-90N.

² Section XVIII of the Agreement

from these tariffs. The DOD views all three of these new tariffs as major enhancements to the Agreement.

VI. THE OVERCOLLECTION OF FIXED CTC REVENUES BELONGS TO THE COMPANY'S CUSTOMERS

In the 05-0650 proceeding, the parties discussed various mechanisms for the treatment of fixed CTC revenues upon expiration. RUCO recommended a reduction in rates; others recommended deferred credits with interest. TEP argued that a reduction in rates would hurt its cash flow but conceded at that time that a refund obligation would exist should the Company continue to collect fixed CTC revenues beyond the estimated expiration date of May 2008. In Decision No. 69568, the Commission allowed TEP to continue collecting fixed CTC revenues, subject to refund, deferring final disposition to the then forthcoming rate case (07-0402 proceeding). The Company now seeks to limit its refund obligation to \$32.5 million³. The DOD urges the Commission, consistent with its findings and order in Decision No. 69568, to credit all of the fixed CTC true-up revenues to the PPFAC bank account to offset any projected increases in fuel costs in 2009. We find no rationale or support for a sharing between the Company and its customers of these over-collections.

VII. EFFECTIVE DATE OF NEW RATES

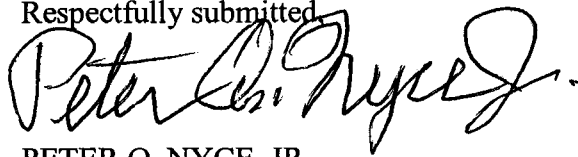
The DOD does not object to the implementation of new rates prior to January 1, 2009.

³ Section XV of the Agreement

VIII. CONCLUSION

For the reasons set-forth above, the DOD recommends approval of the Agreement. It is our view that a decision by the Commission to materially modify or set aside the Agreement could unnecessarily delay a final disposition of the matter to the detriment of both the Company and its customers.

Respectfully submitted,

A handwritten signature in black ink, reading "Peter Q. Nyce, Jr.", written in a cursive style.

PETER Q. NYCE, JR.
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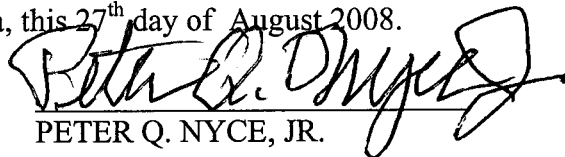
THE DEPARTMENT OF DEFENSE

Dated: Arlington, Virginia this
29th Day of August 2008

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Brief of the United States Department of Defense was sent to the parties on the attached service list either by United Parcel Service Next Day Air or by first class mail, postage prepaid on August 27, 2008 and will be sent by electronic mail on August 29, 2008.

Dated at Arlington County, Virginia, this 27th day of August 2008.


PETER Q. NYCE, JR.

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